

## THE GOLDEN BIRD HAS TAKEN FLIGHT

With Sensex touching new highs on a regular basis, analysts of all shapes and sizes have started to predict fantastic Index levels without really explaining how and why those levels can be reached.

Despite the slowing in the past few years of GDP growth – a worldwide phenomenon – India continues to show positive growth. Things can only improve from here on now that a decisive government has taken over the reins at the center.

As the market starts taking cues from the election outcome, market players have been predicting various Sensex levels. Some are predicting 40000 levels and others are talking about 60000 levels. But all are unanimous that the Sensex is going to reach new highs.

Let us use a rational approach to try and understand the Sensex level possibilities keeping in mind the Market Cap to GDP ratio. This is the classic ratio used by Warren Buffett over a period of time to understand the valuation of the market. History shows that Sensex does not rise continuously to higher levels without the occasional sharp downturn. However, the analysis provides a long term view of possibilities.

India's present GDP is US \$ 2.16 trillion which was US \$1 trillion in November 2007. This is a phenomenal growth and not many would have expected this level to be touched so early. In terms of GDP size we are among the top 10 nations in the world. If we had continued to grow at 9% per annum since 2007, we would have become a US \$5 trillion economy by 2024.

We all know that the growth rate came down from the then 9% levels to the present sub 5%. The reasons have been widely discussed and debated. Having said that, India can still achieve an average growth of 7% which is a very conservative number considering the aspirations and potential of Indian people. If we can continue to achieve an average growth rate of 7% YoY the US \$5 trillion economy number will come by 2027 instead of 2024.

In a fair market scenario, Market Cap to GDP ratio is 1 or 0.9. Presently, the Sensex is at 24200 levels with Market Cap of US \$1.48 trillion and GDP is US \$ 2.16 trillion. The current ratio of Market Cap to GDP is 0.69. The historical high is 1.65; the historical low is 0.41 and a fair market value will be around 0.9.

I have considered three scenarios: the best case (Market Cap to GDP ratio of 1.5), the worst case (Market Cap to GDP ratio 0.4) and the base case (Market Cap to GDP ratio 0.9) and worked out the corresponding Sensex levels, keeping in mind the average GDP growth rate of 7% starting from 4.5% of this year. The Table below gives the projected Sensex levels under all the three scenarios.

### Projected Sensex levels

Year	Best Case	Worst case	Base case
2014	53061	14150	31837
2015	55714	14857	33428
2016	59057	15748	35434
2017	63191	16851	37914
2018	67930	18115	40758

2019	73364	19564	44019
2020	79600	21227	47760
2021	86764	23137	52059
2022	94139	25104	56484
2023	101671	27112	61002
2024	108788	29010	65273
2025	115859	30896	69515
2026	123390	32904	74034
2027	131410	35043	78846

If the economy reaches US \$ 5 trillion then the Sensex should cross 50000 levels while maintaining the present Market Cap to GDP ratio of 0.69. If the ratio goes up from 0.69 to 0.9 or 1.0 the Sensex can cross 80,000 levels. Looks ambitious but still very much within the realm of possibility.

The scenario presented above is especially important in highlighting the importance of long term investment vis-a-vis short term gains. In the short term, there can be many road blocks on the path. During the last few years, the market had been hammered with lot of negativity and with good reasons too. The good old days of 9% GDP growth is history now but the new government needs to take initiatives to pull the economy out of its slumber. Most analysts are predicting numbers based on the *best case* scenario. However, a more likely possibility is of a *base case* scenario over a longer period.

( Note: An average 7% GDP growth has been assumed in the analysis. A GDP growth rate of 4.5% is assumed for the current year and has been gradually increased while keeping the average of 7% for the duration. We might have some period when the economy may grow faster than average and vice versa.)

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